

proceeding strongly supported USTA's position. Nothing has occurred in the last year to mitigate those factors. To the contrary, the uncertainty has only increased as a result of the Interconnection Order and the Recommended Decision on universal service. It would be particularly inequitable to subject rate of return companies to the burdens and consequences of a represcription when these companies have been foreclosed at this time from benefiting from any of the access reforms which the Commission may ultimately adopt.

USTA also presented expert financial testimony by Dr. Randall S. Billingsley which demonstrated the Commission's current authorized rate of return of 11.25 percent was appropriate. At the time of Dr. Billingsley's analysis, the yield on 30-year U.S. Treasury bonds was 6.62 percent in March 1996. As of January 24, 1997, the 30-year Treasury bond yield was 6.88 percent. No significant change in the level of capital costs has been observed.

Further, as the Commission points out, reinitializing price cap indices based on earnings could have a negative effect on the productivity incentives of price cap LECs. (§ 230). Under any regularly recurring reinitialization schedule, LECs will have little incentive to introduce cost-saving innovations since there is no opportunity to benefit from such efficiencies. Any gains will be taxed away. In an affidavit appended hereto at Attachment 4, Dr. James H. Vander Weide states that the Commission should reject proposals to reinitialize price cap indices that would result in rates targeted to yield a rate of return of 11.25 percent, prescribe a new rate of return as a basis upon which to reinitialize PCIs or adopt productivity proposals designed to reduce the LECs' access rates to the point that their regulatory accounting rates of return equal their prescribed economic cost of capital. "Adopting such proposals would reintroduce the same

skewed incentives and administrative burdens that the Commission sought to avoid when it adopted its Price Cap Plan.”²⁷ Dr. Vander Weide further states that based on a review of the LECs’ economic rates of return on capital rather than their accounting rates of return on capital, the LECs’ economic rate of return during the period 1991 through 1995 is significantly less than the 11.25 percent benchmark rate of return. Dr. Vander Weide explains that economic rates of return are the only rates of return that can be meaningfully compared to the LECs’ economic cost of capital. According to Dr. Vander Weide, the LECs’ 8.75 percent economic rate of return is well below the Commission’s 11.25 percent rate of return benchmark.²⁸ For that reason, as discussed in its filings in CC Docket No. 94-1, USTA continues to oppose using interstate accounting earnings as a measure of productivity.

A reinitialization process could also create market distortions. For example, if rates are set too high, inefficient entry will occur. Conversely, if rates are too low, even efficient entry will be discouraged. A market-based approach will maintain productivity incentives and provide appropriate incentives to encourage efficient entry.

3. The Interim Price Cap Plan Should be Revised to Eliminate Sharing and to Rely on Competition to Discipline Pricing. (Paragraphs 231-235)

The Commission should eliminate the sharing requirements in the current price cap plan, regardless of the approach it takes regarding access reform. As the Commission has properly recognized, sharing defeats the goals of price cap regulation. It blunts the incentives of LECs to

²⁷Affidavit of Dr. James H. Vander Weide at 4.

²⁸Id. at 5.

reduce costs, invest in the infrastructure and introduce new services. It perpetuates expensive and burdensome cost allocation procedures which are not necessary under price cap regulation. Competition in the access markets will continue to grow at a rapid pace, even if the prescriptive approach is adopted. In the current, competitive access environment, sharing serves no purpose.

As intended by the Act, efficient competitive dynamics will discipline pricing. Particularly for high margin business services in the densest market geographies, competitive pricing pressure will be intense. As competition grows, more services will be subject to competitive influences. Consequently, price cap regulation should apply to an ever decreasing number of services. The availability of unbundled network elements will drive all access prices down, even for less competitive services, regardless of the X-factor selected by the Commission. An additional mechanism mandated by the Commission to drive prices down, would be superfluous and would only serve to interfere with efficient pricing and market-based outcomes. (¶ 232). Indeed, the X factor becomes irrelevant as LECs respond to competition and more services are removed from price cap regulation.

Productivity estimates based on historical studies will overestimate the productivity potential of price cap LECs in a post-access reform environment. Therefore, any changes in the current access rate structure should be reflected in the X-factor. For example, as recommended by USTA, assessing the CCL on a flat rate, per line basis will reduce the LECs' productivity measurement by shifting revenue sources from rapidly increasing demand units (minutes of use) to demand units (presubscribed lines, universal service fund) which will grow more slowly and may even decline. CCL minutes of use growth has exceeded line growth by at least four percent

over the past five years. The CCL PCI formula already reduces CCL prices by "g/2", which, in effect, cuts in half the minutes of use growth above line growth. If the Commission adopts USTA's proposal to recover CCL, it should also eliminate the "g/2" components of the formula.²⁹ In addition, recovery of residual TIC amounts on a flat rate, bulk billed basis will experience the same result.³⁰

The Commission should also recognize that competitive losses will impact the X-factor. Competitive losses will affect LECs' abilities to achieve a productivity measure that is too high while their prices are constrained. For example, a ten percent loss in market share over a five year period reduces revenues by two percent each year which will reduce the TFP by approximately one percent each year.

The level of the X-factor should be based on the five-year moving average total factor productivity (TFP) results prepared by Christensen Associates and appended hereto as Attachment 5. As the Commission itself concluded, the TFP approach is appropriate to determine productivity for use in setting the X-factor because it is easily verifiable and relies on publicly available data. However, USTA will support the use of a fixed factor, determined by the

²⁹CCL revenue, excluding payphone, represents approximately fourteen percent of total price cap revenues. Given that CCL minutes of use growth has exceeded line growth by four percent and the impact of the "g/2" calculation, CCL restructuring will reduce total interstate price cap revenue growth by about 0.3 percent per year.

³⁰Traffic Sensitive minutes of use growth has been about 7 percent per year. TIC revenues currently represent about 12.6 percent of total price cap revenues. If bulk billing results in zero demand growth, TIC restructuring will reduce total interstate price cap revenue growth by about 0.9 percent per year.

TFP, to further facilitate administrative simplicity.

The TFP model has been updated to include results for 1995. The TFP differential that forms the basis of the X-factor is 2.7 percent over the most recent five year period.³¹ However, the effects of the restructuring of the CCL and the TIC as recommended by USTA will reduce measured TFP on a total company basis by 0.4 percentage points per year.³² Any rate restructure adopted by the Commission must be reflected in an X-factor which is appropriate for a post access reform environment.

USTA continues to oppose the inclusion of an input inflation differential since this only serves to reduce the accuracy and reliability of the X-factor. In addition, USTA continues to oppose the application of a consumer productivity dividend (CPD). The CPD was established to assure access customers (primarily IXCs and large business users) a specific financial benefit when price cap regulation was implemented. Since then, those customers have received a total benefit of \$2.1 billion. Unfortunately, as noted earlier, IXCs have not passed that benefit through to their end user customers. The competitive paradigm demands that the price cap LECs not be forced to subsidize their competitors. The CPD has served its purpose and should be eliminated.

³¹Christensen Associates, "Updated Results for the Simplified TFPRP Model and Response to Productivity Questions in FCC's Access Reform Proceeding", January 24, 1997 at 2-3.

³²Id. at 7. The restructuring of the CCL and TIC as recommended by USTA is estimated to reduce an X-factor based on interstate only results, *i.e.*, the Frentrup/Uretsky model, by 1.4 percentage points. Christensen at 8.

As discussed in CC Docket No. 94-1, the Commission should not rely on flawed analyses such as the Performance-Based Productivity Model submitted by AT&T in that proceeding. As explained in the analysis performed by Christensen Associates and appended hereto at Attachment 6, basing the X factor on historical output price growth, entirely independent of the actual changes which will result from access reform, will misrepresent actual, achieved productivity. The AT&T model is inconsistent with the Commission's objective to adopt an economically-meaningful productivity measure. USTA's comments in CC Docket No. 94-1 also completely discredited the approach taken by MCI and others to compute the X-factor.³³

Finally, the rules governing instances where a filing causes the API to exceed the PCI should be maintained. (§ 235). Currently, the required cost showing is based on embedded costs. This ensures that LECs are able to adequately recover capital, thereby avoiding stranded investment. Stranded investment reduces the LECs' abilities to achieve adequate earnings, which is consequently reflected in rate agencies' analyses. A downward adjustment ultimately will reduce the LEC's ability to attract capital funding, one of the reasons the Commission permits above cap filings. Requiring the use of forward-looking costs to justify above cap filings would have the very effect on the LEC that the Commission has attempted to avoid by allowing above cap rates to go into effect.

³³See, Attachment 7.

II. A MARKET BASED APPROACH TO ACCESS REFORM WILL BEST SERVE THE PUBLIC INTEREST (Paragraphs 161-217).

In the presence of competitive entry maintaining unneeded regulatory constraints on the incumbent has the potential of distorting market outcomes and having long-lasting deleterious effects on industry performance...[T]he exchange access market has experienced substantial competition for select customers and is likely to increase as a result of increasing technological dynamics and regulatory change. Unnecessary incumbent constraints... raise incumbent costs at a time when cost reductions are essential to compete with competitors which do not have incumbent obligations such as carrier of last resort and universal service requirements. As experience in other industries indicate, maintaining unnecessary regulations on incumbents long after competitive entry has occurred causes economic harm to the incumbent provider, consumers and the economy as a whole.³⁴

Given the infirmities of the prescriptive approach and the benefits of a market-based approach, USTA has designed a plan which is pro-competitive and ultimately deregulatory, yet retains regulation where it is still needed as a substitute for competition. It removes the unnecessary asymmetric obligations imposed on the incumbent LECs to the greatest extent possible without compromising competitive goals. Under USTA's plan, a provider's efficiencies and abilities to supply customer demands will determine success in the marketplace, not regulatory fiat.

³⁴Schmalensee and Taylor at 22.

A. Market Determinants for Regulatory Flexibility Must be Based on Current Market Conditions and Accommodate the Rapid Growth of Competition (Paragraphs 168-200)

“Paradoxically, the Commission’s market-based approach imposes more regulation and less reliance on the market.”³⁵ One of the problems with the market phases set forth in the NPRM is that they ignore current marketplace conditions. The proposed Phase I rule changes presume that the current rules are appropriate. The current rules were established in 1983 and were intended to apply to a regulatory monopoly environment. Such an environment no longer exists. In 1995, USTA presented data in CC Docket No. 94-1 with hundreds of examples where a vital and compelling competitive interstate access market already exists.³⁶ USTA also provided data depicting exchange carrier high capacity service (special access and intraLATA point-to-point services for DS0, DS1, DS3) losses to competitors.³⁷ This was before the passage of the 1996 Act. It makes no sense to establish a market-based approach which is based on 1983 market assumptions. The Phase I criteria must reflect the market that exists in 1997 and provide the regulatory relief that is needed today.

³⁵Sidak and Spulber at 15.

³⁶USTA Comments, Price Cap Performance Review for Local Exchange Carriers, CC Docket No. 94-1, filed December 11, 1995 at Attachment 2.

³⁷USTA Reply Comments, Price Cap Performance Review for Local Exchange Carriers, CC Docket No. 94-1, filed January 11, 1996.

As depicted in the chart at Attachment 8, USTA proposes that regulation of specific services reflect the competitive nature of that market. As the markets become more competitive, regulatory oversight should be reduced. USTA proposes two phases of regulation, followed by forbearance. Phase 1 regulation is applied to services on a state-wide (study area) basis where unbundled elements are available through effective interconnection agreements. Pricing flexibility necessary to accommodate current market conditions is provided. In Phase 2, services are removed from price caps in specific geographic areas where competitors have made use of unbundled elements or provide comparable service over their own networks. Regulation should be forborne at any time for those services in geographic areas that meet the criteria of Section 10(a) of the 1996 Act. The transition of services from Phase 1 to Phase 2 should occur on a service by service basis and by geographic area.

There are a number of important variables for determining the competitive nature of the access marketplace. The addressability of the geographic area is key.³⁸ Acknowledging the

³⁸In the past, there was a need to define the “relevant market areas” for which a determination of competitive presence would be made. With the availability of unbundled elements and the state determination and oversight of interconnection agreements, the market area for most access services is defined as the state, or a LEC operating area within a state. However, for switched access services, USTA proposes that smaller geographic areas, e.g., an Exchange area or group of Exchange areas, may be more appropriate.

differences between special access and switched access is also required.³⁹ In addition, the Commission must recognize that the development of competition and the concomitant relief may not occur in the exact sequences described herein or, for that matter, as described in the Commission's proposal. As the Act specifies, the Commission is *required* to forbear at any time the criteria contained in Section 10 are met for any service or group of services or for any carrier or group of carriers except as explained in Section 10(d).

1. Reduced Regulation and Increased Pricing Flexibility Should Occur in Phase I to Reflect Current Market Conditions. (Paragraphs 168-200).

The Commission's price cap rules for switched access severely restrict the LECs' abilities to respond to competition.

The first changes in regulation are intended to eliminate unnecessary constraints which do not reward efficiency and prevent the least-cost supplier from providing the service. This change should occur when the market is *first* opened to competitors so that entrants and incumbents will make efficient entry and exit decisions...At this stage regulation should be immediately adjusted so that it provides neither the entrant nor the incumbent any net advantage on a forward-looking basis. In order for competitors to be given accurate and efficient price signals, they must compete with firms on as a symmetric basis as possible.⁴⁰

³⁹Special access is provided over facilities dedicated to a customer that do not require switching. Switched access provides customers access to all customers on the public switched network. Connections to the switch can be made by dedicated facilities or common facilities.

⁴⁰Schmalensee and Taylor at 25.

The Phase 1 regulatory structure should be adopted, in a state, when a state-approved interconnection agreement or Statement of Generally Available Terms (SGAT) becomes effective. The geographic area for which relief is warranted would match the area covered by the interconnection agreement or the SGAT. These agreements require incumbent LECs to provide resale, number portability, dialing parity, access to rights of way, reciprocal compensation, interconnection with the LEC network, unbundled access to network elements, and collocation. Meeting these requirements ensures the removal of any remaining entry barriers and the availability of alternative means of supply. In addition, the availability of unbundled elements will constrain the LEC's ability to raise its access rates. Once such an agreement becomes effective, regulatory relief is warranted.

USTA's proposal to require pricing flexibility on a state-wide basis in light of state-approved interconnection agreements of Generally Available Terms is appropriate and sound economics. Because it reduces unneeded asymmetrical obligations *after* competition has been authorized USTA's proposal provides ample protection. A state-approved interconnection agreement or Statement of Generally Available Terms is evidence that competitors are likely to enter the market or have increased ability to enter the market--even in areas that previously would not have been served by competitors.⁴¹

For switched access services in Phase 1 areas, the existing Part 69 rules for price cap LECs should no longer apply. The price cap basket structure, as described below should be

⁴¹Id. at 28.

simplified to consolidate the current baskets and service categories. LECs should be permitted to deaverage switched access service rates by geographic area and class of customer, to offer volume and term discounts, and to offer contract tariffs and responses to RFPs⁴². New services should be deregulated.

Deaveraging switched access services rates by geographic area and class of customers more closely aligns rates with the way ILECs incur costs and leads to efficiency improvements...This is especially important in the early stages of competitive alternatives because efficient entry decisions should be made on the basis of economic cost...Permitting ILECs price flexibility to respond to competitive alternatives leads to improvements in resource allocation and efficiency. Volume and term discounts, contract tariffs and responses to RFPs promote efficient utilization of telecommunications resources by more closely aligning customer preferences with the firm's per unit costs...The Courts, the Commission, and economic science have recognized that permitting a firm to reduce or restructure prices to retain customers or service volumes that it would otherwise lose to competitors would result in *lower* prices for all consumers...⁴³

The Phase 1 regulatory structure should also be adopted for the Database services, and Tandem Switching and Transport services, i.e., direct trunked transport terminated in non-collocated central offices and common transport services, on a statewide basis when a state-approved interconnection agreement or a Statement of Generally Available Terms becomes effective. For these services, the additional regulatory flexibility provided in Phase 1 should be

⁴²Services offered under contract would be removed from price caps.

⁴³Schmalensee and Taylor at 30.

the same as for switched access services.

2. Services Should Be Removed From Price Cap Regulation in Phase 2. (Paragraphs 201-217).

When competitive forces effectively constrain prices for a particular product in a geographic area, regulation of these prices no longer provides benefits that offset their accompanying costs, and regulation should be eliminated. The requirements of the 1996 Act ensure that all barriers to entry are removed. The offering of unbundled elements by incumbent LECs ensures the availability of alternative sources of supply throughout a service area. The offering of unbundled elements also ensures that the services offered by competitors are essentially the same as the services offered by the incumbent LECs and that end user customers may easily move from one provider to another. The availability of alternate supply of essentially identical services will restrict the ability of the LEC to raise its access rates.

For switched access services and the other services still under price cap regulation, the transition to Phase 2 should be allowed to occur in specific geographic areas smaller than a state, e.g., an exchange area or group of exchange areas, because competitors most likely will only target specific geographic areas when first entering a market. These services should transition to Phase 2 when an interconnection agreement becomes effective with one or more carriers *and* the corresponding unbundled elements are in use by a competing carrier, *or* competing carriers are

offering services using their own facilities in that area.

The criteria to be used in making a showing for Phase 2, would include a demonstration that actual competition exists. Such a demonstration could include evidence that barriers to entry are removed, that state regulators have approved interconnection agreements with one or more competitors, that NXX codes are assigned to competitors, that minutes are being exchanged with competitors, as well as a list of competitors in the market, a listing of services offered by competitors, and a description of geographic areas served by the competitors.

Services subject to Phase 2 streamlined regulations will be removed from price cap regulation, exempted from the application of any rules that may apply to price cap LECs in lieu of Part 69, and allowed tariff filings on one days notice without cost support. Such tariffs shall be presumed lawful. These services would still be subject to Title II regulatory oversight.

“USTA’s proposal to place services in a Phase II category--after an examination of the evidence on a geographic basis reveals and demonstrates that actual competition is present--is consistent with our economic analysis. USTA’s trigger for placing a service in Phase II ensures that barriers to entry are sufficiently low so that new competitors would prevent incumbents from maintaining prices above competitive levels. An interconnection agreement coupled with actual use of facilities provides a sufficient basis upon which to determine that, in the case of a

particular service in a specific geographic area, market forces are sufficient to constrain prices.”⁴⁴

In most cases, neither the PCIs nor the APIs will have to be revised when services are removed from price cap regulation. (§ 154). However, if the entire demand associated with a specific rate element within a specific geographic area is removed from price cap regulation, the demand quantities used in the API and SBI calculations and the associated revenue weights should be removed from the PCI calculations.⁴⁵ The result is to attribute any existing “headroom” to services remaining in price caps in proportion to revenue shares. If only a portion of an existing rate element is removed from price cap regulation, an exogenous-like reduction is necessary to reduce the PCI or upper SBI limit.⁴⁶ The same proportionate reduction would be applied to the corresponding API or SBI. The same rules apply when amounts are restructured from one category to another.

⁴⁴Id. at 34.

⁴⁵By removing the demand for these elements, the API weights are recomputed based only on the services remaining under price caps. The percentage by which the API is below the PCI is unchanged. Because revenue amounts have been removed from the $P \times Q$ computations, the dollar amount of “headroom”, if any, is reduced in proportion to the revenues ($P \times Q$) associated with the services removed from price caps.

⁴⁶This situation would occur when services are removed from price cap regulation pursuant to Phase 2 of USTA’s plan. For example, if transport services in Houston, Texas qualified for Phase 2, the entire Houston transport demand (Q times P) would be removed from Texas Zone 1 SBI calculations.

To facilitate restructure and to improve price cap mechanics, each category or zone with an upper SBI limit should contain a term, $(R + \Delta Z)/R$. The effect of this change would be to allow accurate targeting of any changes.

3. Forbearance is Required Whenever the Criteria of Section 10 are Met. (Paragraphs 140-160).

Forbearance from regulation of a service must occur when the three pronged test of Section 10(a) of the Act is met: enforcement of the rule or regulation is not necessary to ensure that rates are just and reasonable or not unjustly or unreasonably discriminatory; enforcement of the rule or regulation is not necessary for the protection of consumers, and forbearance is consistent with the public interest. The competitive impact must also be considered. Forborne services would still be subject to Title II oversight, including Sections 201 and 202 that require just, reasonable and nondiscriminatory rates and the complaint procedures contained in Section 206 through 209.

B. The 1996 Act and the Competitive Marketplace will Provide Appropriate Safeguards.

The 1996 Act greatly reduces any legal, regulatory, economic and operational barriers to entry. The Act provides competitors with three opportunities to enter the local exchange and exchange access markets: construction of new networks, the use of unbundled elements of the incumbent LEC's network and the resale of incumbent LEC retail services.

Under the terms of the Interconnection Order, unbundled network elements may be combined to provide a total exchange access service equivalent to conventional access service--provided that the competitor "wins" the end user. This allows a CLEC, for example, to purchase unbundled loops, local switching, signaling, and transport to provide exchange access. In essence, a competitor need not invest in loops, switches or transport to provide exchange access. The Interconnection Order also concludes that operations support systems and the information they contain are network elements. Competitors will be able to electronically bond with the ILEC's preordering, ordering, provisioning, maintenance and repair and billing systems. This ability provides competitors with nondiscriminatory operations support systems, which in turn minimizes the ability of the ILEC to engage in non-price discrimination. While we may not agree with every aspect of the unbundling rules contained in the Order, if the Commission is going to interpret the Act in this way, it becomes more urgent to grant flexibility to the ILEC. These requirements act to prevent or limit ILECs from exercising market power in access markets. Because of this, increased regulatory flexibility is appropriate.⁴⁷

By utilizing the requirements of the Act as the basis for reducing and eliminating regulation as in USTA's plan, appropriate safeguards exist to prevent anticompetitive behavior.

While the U.S. Supreme Court has stated that predatory pricing schemes are "rarely tried and even more rarely successful",⁴⁸ many incumbent LEC competitors still allege that incumbent LECs will engage in such schemes. Predatory pricing requires that three conditions exist: the predator must be a dominant firm or likely to become one, market structure must allow later recoupment of funds invested in predation and the predator must invest in the elimination of its

⁴⁷Schmalensee and Taylor at 11.

⁴⁸Matsushita Electric Industrial Co. v. Zenith Radio Corp., 475 U.S. 574 (1986).

competitor. The elimination of barriers to entry and the prohibition on pricing below cost address these concerns.

While pure price cap regulation eliminates the ability and incentive to cross-subsidize competitive services, competition resulting from the elimination of barriers to entry in both the local and exchange access markets will offer “belt and suspenders” protection against cross subsidization.

Finally, competition for access services in conjunction with the Act’s requirements prohibiting price discrimination, will eliminate opportunities for incumbent LECs to engage in a price squeeze strategy as has been alleged by some incumbent LEC competitors. Eliminating the barriers to entry is dismantling any alleged bottleneck upon which the success of the price squeeze strategy exists. The safeguards contained in Section 272 of the Act also prevent a price squeeze from occurring.

The safeguards provided in the 1996 Act are sufficient to prevent discriminatory treatment of competitors or to engage in anticompetitive behavior. “[I]ncreasing competition for access services from facilities-based competitors and from the use of unbundled elements for access will make anticompetitive strategies impossible and unprofitable to undertake. Such competition--coupled with the Commission’s existing and new anti-discrimination rules--will prevent anticompetitive behavior in the interexchange and carrier access markets during a

market-based transition to efficient access prices.”⁴⁹

C. Incumbent LECs Should be Afforded Opportunities to Respond to Competition.

Allowing incumbent LECs the flexibility to respond to market conditions will send the proper economic signals which further enhance competition. By allowing incumbent LECs to compete effectively, pricing will be more efficient and consumers guaranteed more choices. A true market-based approach requires that the regulatory reforms proposed in USTA’s plan be adopted.

1. Certain Services are Already Subject to Substantial Competition and Meet the Criteria Which Requires the Commission to Forbear From Regulation in Phase 1.

Services in the Interexchange Basket, special access, collocated direct trunked transport and directory assistance are already subject to sufficient competition and meet the criteria in Section 10(a) of the Act which requires the Commission to forbear from regulation. These services should be forborne in Phase I of the market-based plan.⁵⁰

⁴⁹Schmalensee and Taylor at 42.

⁵⁰USTA is not proposing that the Commission forbear from any of the requirements of Section 251(c).

Interexchange Basket Services.

When establishing this basket in the original LEC Price Cap Order, the Commission recognized that "[i]nterexchange services provided by LECs are *limited*."⁵¹ Services in the Interexchange Basket consist mainly of corridor service,⁵² International Message Telephone Service ("IMTS"),⁵³ and other interexchange offerings such as interstate intraLATA service and interstate operator surcharges.⁵⁴

The purpose of the price cap baskets is to curb a carrier's pricing flexibility as well as its

⁵¹See, Policy and Rules Concerning Rates for Dominant Carriers, Second Report and Order, 5 FCC Rcd 6786, 6811 (1990) ("LEC Price Cap Order"). (Emphasis added.)

⁵²After divestiture Bell Atlantic and NYNEX were allowed to continue providing interstate interLATA service between New York City and Northern New Jersey, Philadelphia and Camden, and part of New York State to Greenwich and Byram, Connecticut. Corridor service was created to "preserve for interstate callers in these areas the advantages of existing local networks." United States v. Western Electric Co., 569 F. Supp. 1057, 1107 (D.D.C. 1983).

⁵³Offered only by GTE Hawaiian Tel.

⁵⁴ LEC Price Cap Order at 6812. Some LECs include services such as Line Information Data Base ("LIDB"), directory assistance, operator transfer, and busy line verification and interrupt in the Interexchange Basket. If the Commission should decide that forbearance is not appropriate for certain of these services, in particular operator transfer and busy line verification and interrupt, they could be moved to the Local Switching category so that the Interexchange Basket could be eliminated.

ability to engage in unlawful cost shifting between broad groups of services.⁵⁵ The Interexchange Basket is no longer needed for that purpose. Cost shifting interexchange costs to another basket is a meaningless exercise under price cap regulation where costs do not determine rates and all markets are becoming increasingly competitive.

Interstate interexchange and international services are highly competitive as evidenced by the Commission's recent reclassification of AT&T as a nondominant domestic and IMTS carrier⁵⁶ and GTE Hawaiian Tel. as a nondominant IMTS carrier.⁵⁷ The Commission found that in the domestic market, AT&T's market power over certain *de minimis* services did not warrant retaining the dominant carrier classification as AT&T lacked *overall* market power for domestic, interstate, interexchange services and because dominant carrier classification stifled innovation

⁵⁵Id. at 6811.

⁵⁶See, Motion of AT&T Corp. To be Reclassified as a Non-Dominant Carrier, Order, 11 FCC Rcd 3271 (1995) ("AT&T Domestic Order"); Motion of AT&T Corp. To Be Declared Non-Dominant, Order, FCC 96-209, (released May 14, 1996) ("AT&T International Order"). The AT&T Domestic Order and AT&T International Order are collectively referred to herein as the AT&T Non-Dominance Proceeding.

⁵⁷See, Petition of GTE Hawaiian Telephone Company, Inc. for Reclassification as a Nondominant IMTS Carrier, Order, DA 96-1748 (released October 22, 1996) ("GTE International Order"). In this Order, the Commission reclassified GTE Hawaiian Tel as nondominant and removed its IMTS from price cap regulation, even on those routes where it is still dominant; *i.e.*, Venezuela and the Dominican Republic, subject to the establishment of a Competitive Carrier affiliate.

and imposed compliance costs on AT&T.⁵⁸ Just as it ignored *de minimis* services in the domestic market, the Commission forbore from regulating international routes that "constitute a *de minimis* share of total U.S. billed minutes" and reclassified AT&T and GTE Hawaiian Tel as nondominant for IMTS.⁵⁹ GTE Hawaiian Tel.'s reclassification removes all IMTS from the Interexchange Basket.⁶⁰

Under the three-pronged forbearance test contained in Section 10 of the Act, the services in the Interexchange Basket clearly should immediately be forborne from regulation.⁶¹

The first two prongs of the forbearance test are satisfied by the Commission's finding in

⁵⁸See, AT&T Domestic Order at 3356-3357; see also, AT&T International Order at n.18.

⁵⁹See, AT&T International Order at ¶ 2 (footnote omitted); GTE International Order at ¶¶ 56-59.

⁶⁰While market share is not appropriate as a trigger for regulatory relief, it is useful here to demonstrate the *de minimis* impact of LEC participation in the interexchange market.

⁶¹The Commission seeks comment on whether it should forbear from applying the requirements of Section 254(g) to IXC's. (¶ 182). USTA has opposed such requests in the past. See, Opposition of USTA, Implementation of Section 254(g) of the Communications Act of 1996, CC Docket No. 96-61, October 21, 1996 at 3. Forbearance of this section does not meet the criteria of Section 10. Enforcement is necessary to ensure just, reasonable and nondiscriminatory rates, enforcement is necessary for the protection of rural consumers and the public interest would not be served. Forbearance would be contrary to Section 254(b)(3) which requires that rural customers have access to interexchange services at rates that are reasonably comparable to urban rates.

the AT&T Domestic Order that the domestic, interstate, interexchange market was sufficiently competitive to reclassify AT&T as nondominant even though AT&T retained a 58 percent share of the market. If AT&T, which today has an approximate 53 percent market share of both minutes and revenues,⁶² cannot exert market power to control prices, then it is virtually impossible for the price cap LECs to exert market power for the services they offer in competition with all nondominant interexchange carriers. The total LEC industry's share of the interstate long distance market is 13.6 percent – significantly smaller than AT&T's.⁶³ Finally, even if forborne, incumbent LECs will still be regulated under Title II of the Act. Thus, price cap regulation is not required to ensure just, reasonable and nondiscriminatory rates and is not required for the protection of consumers.

The third prong is satisfied by the *de minimis* standards employed by the Commission in the AT&T Non-Dominance proceeding and the GTE International Order. LEC interstate traffic is clearly *de minimis* when compared to *overall* domestic, interstate, interexchange minutes and revenues. Just as the Commission found in the AT&T International Order, the "economic costs of dominant carrier regulation -- e.g., inhibiting innovation in prices or services, imposition of

⁶²LONG DISTANCE MARKET SHARES: Third Quarter 1996, Industry Analysis Division, Common Carrier Bureau at Table 3 and Table 6 (Jan. 1997).

⁶³The Bell Operating Companies' share is 9.8 percent and all other LECs' share is 3.8 percent. *Id.* at Table 5.

substantial compliance on parties and administrative costs on the Commission -- for routes with such *de minimis* traffic ... can impede, rather than promote competitive market conditions...."⁶⁴

The public interest will be served by forbearing from regulation of interexchange services.

Corridor service is strictly limited geographically to certain routes and, according to AT&T, is extremely competitive.⁶⁵ As demonstrated by Bell Atlantic, its two main corridor routes are served by approximately 90 interexchange providers.⁶⁶ "Roughly 90% of the potential customers in the corridors never use Bell Atlantic corridor service."⁶⁷ The total minutes-of-use represented by corridor traffic is only .2836 percent and total revenues represent only .0504 percent.⁶⁸ It is in the public interest to allow all providers in a competitive market to compete on

⁶⁴AT&T International Order at ¶ 97.

⁶⁵See, AT&T Petition for Waiver of Section 64.1701 of the Commission's Rules filed October 25, 1996.

⁶⁶See, Petition to regulate Bell Atlantic as a Nondominant Provider of Interstate InterLATA Corridor Service, Petition, July 7, 1995, at 2.

⁶⁷Id.

⁶⁸LONG DISTANCE MARKET SHARES: Third Quarter 1996, Industry Analysis Division, Common Carrier Bureau, Table 2 MOUs of 117.7 billion and Table 5 revenues of \$83,782 million (Jan. 1997). The RBOCs are required by statute to initially offer in-region interLATA services through a separate affiliate; therefore, these services would not be reflected in the Interexchange Basket. See, also, Bell Atlantic 1996 Annual Filing Data, Transmittal No. 887, filed June 27, 1996 and NYNEX 1996 Annual Filing Data, Transmittal No. 420, filed June 27,

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the same basis. Clearly, the forbearance test is met for corridor service. Forbearance will not impact rates and will not harm consumers. The public interest will be served by permitting fair competition.

Interstate intraLATA service is also highly competitive and will only become more so with the implementation of dialing parity as required by the 1996 Act. Again, price cap regulation is not required for interstate intraLATA services as competition will ensure that rates are just and reasonable, that consumers are protected and that the public interest is served.

Operator surcharges associated with interstate calling are also competitive. There were approximately 350 providers in the operator services and calling card markets in 1995.⁶⁹ The two largest interexchange carriers heavily advertise their 1+800 service (1+800-CALLATT and 1+800-COLLECT) both of which bypass LEC call completion services. In addition, thousands of private payphones in LEC operating areas are presubscribed to non-LEC operator services providers. Prepaid phone cards, which have become increasingly popular,⁷⁰ also bypass LEC

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1996.

⁶⁹See, Frost and Sullivan, 1996 Report Chapter 3, "Total Operator Services and Calling Card Market," p.31.

⁷⁰See, e.g., Atlanta Constitution, "Prepaid Cards for Phone Calls Gain Popularity," p.E3, August 14, 1995.